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SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. 42099

E.I. DUPONT DE NEMOURS AND COMPANY

v.

CSX TRANSPORTATION, INC.

Decided: June 27, 2008

The Board finds that the defendant railroad has market dominance over the transportation at issue and that the challenged rates are unreasonably high. The railroad is directed to establish new rates that do not exceed the maximum reasonable rates prescribed herein and to pay reparations (with interest) to the shipper.

BY THE BOARD:

By an amended complaint filed on October 30, 2007, E.I. du Pont de Nemours and Company (DuPont) challenges the reasonableness of rates charged by CSX Transportation, Inc. (CSXT) for three movements: (1) the movement of synthetic plastic powder from Amthill, VA, to Wyandotte, MI, a distance of approximately 820 miles (Amthill movement); (2) the movement of plasticizers from Heyden, NJ, to Duart, NC, a distance of approximately 714 miles (Duart movement); and (3) the movement of plasticizers from Heyden, NJ, to Washington, WV, a distance of approximately 646 miles (Washington movement). DuPont seeks relief pursuant to the simplified procedures set forth in Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007) (Simplified Standards).¹

DuPont has elected to proceed under the Three-Benchmark method, under which the total available rate relief is limited to \$1 million over a 5-year period. In its opening evidence, CSXT seeks to relitigate various methodological issues related to the application of the Three-Benchmark approach. CSXT Open at 8-14. However, those arguments were presented and rejected in Simplified Standards. CSXT may not collaterally attack Simplified Standards in this proceeding.

¹ Pet. for review docketed, No. 07-1369, et al. (D.C. Cir. Sept. 18, 2007).

Based on the record presented, we find that the rates challenged here are unreasonably high under the Three-Benchmark method. Accordingly, maximum reasonable rates are prescribed and reparations (with interest) are awarded to DuPont.

MARKET DOMINANCE

We can consider the reasonableness of a challenged rail rate only if the carrier has market dominance over the traffic involved. 49 U.S.C. 10707. Market dominance is “an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies.” 49 U.S.C. 10707(a). Where a railroad has market dominance, its transportation rate must be reasonable. 49 U.S.C. 10701(d)(1), 10702.

There are two components to the Board’s market dominance inquiry. The first component is quantitative. The statute establishes a conclusive presumption that a railroad does not have market dominance if the rate it charges produces revenues that are less than 180% of its variable costs² of providing the service. 49 U.S.C. 10707(d)(1)(A). Thus, the 180% revenue-to-variable-cost (R/VC) ratio is the floor for regulatory scrutiny of rail rates. That statutory 180% R/VC level is also the floor for any rate relief. See Burlington N.R.R. v. STB, 114 F.3d 206, 210 (D.C. Cir. 1997).

If the quantitative threshold is met, we move to the second component. In this qualitative analysis, we determine whether there are any feasible transportation alternatives that could be used for the issue traffic. The Board considers both intramodal competition (from other railroads) and intermodal competition (from other modes of transportation, such as trucks, transload arrangements, barges or pipelines).

Here, the parties agree that CSXT’s R/VC ratios exceed the 180% threshold for all three movements at issue.³ Therefore, DuPont has satisfied the quantitative prong of the market dominance inquiry. The parties disagree, however, on whether the qualitative market dominance test has been met.

In the qualitative market dominance inquiry, the complainant bears the burden of establishing the absence of effective competition from other rail carriers or modes of transportation for the traffic to which the challenged rate applies.⁴ See 49 U.S.C. 10707. Even where an alternative mode or modes of transportation exists, a complainant can establish market

² Variable costs are those railroad costs which vary with the level of output.

³ DuPont Open. at 9; CSXT Reply at 3.

⁴ See CSX Corp. et al. – Control – Conrail Inc. et al., 3 S.T.B. 196 (1998); Government of the Territory of Guam v. Sea-Land Serv., Inc., STB Docket No. WCC-101, slip op. at 6 (STB served Feb. 2, 2007) (“In rail cases, because a finding of market dominance is a threshold jurisdictional requirement, we place the burden of proof on the shipper to show that there is not effective competition.”).

dominance by demonstrating that the alternate modes of transportation are not effectively constraining the carrier's ability to increase the rates of the issue traffic.⁵

After reviewing the parties' evidence and argument, we conclude that CSXT has market dominance with respect to all three movements at issue.

Duart and Washington Movements

1. Position of the Parties

DuPont asserts that CSXT faces no effective intermodal competition for the Duart and Washington movements of liquid plasticizers.⁶ DuPont states that CSXT is the only rail carrier that serves Duart and Washington, and that there is no water carriage alternative to CSXT for these movements.⁷ Further, DuPont asserts that the trucking of plasticizers is not a feasible alternative because of the high risk of contamination.⁸ According to DuPont, the physical characteristics of plasticizers make them inherently more susceptible to contamination and render trucks an ineffective competitive alternative to rail.⁹ DuPont argues that the risk of contamination would greatly increase if plasticizers were transloaded from rail to truck or vice-versa, as the plasticizers would need to be pumped between tank truck and rail car.¹⁰

DuPont states that it has never shipped the plasticizer movements at issue by truck. It also maintains that the cost of transporting plasticizers by truck, particularly after considering additional steps needed to reduce the risk of contamination, would greatly exceed its total rail costs.¹¹ DuPont asserts that the base-rate quotes it has received for trucking these movements, which are below the rail rates, do not include fuel surcharge costs, detention and accessorial charges, and the labor costs required to unload the quantity of trucks that would be required to transport the volume of plasticizers in these movements.¹² As a result of these additional truck-related costs, DuPont argues that the total costs of trucking plasticizers would far exceed its total rail costs, further negating the possibility that trucking plasticizers is a viable alternative to rail.¹³

⁵ See Market Dominance Determination and Consideration of Product Competition, 365 I.C.C. 118, 129 (1981) ("Effective competition for a firm providing a good or service means that there must be pressures on that firm to perform up to standards and at reasonable prices, or lose desirable business.").

⁶ DuPont Open. at 10.

⁷ Id. at 9-10.

⁸ Id. at 11-12.

⁹ Id.

¹⁰ Id.

¹¹ Id. at 12-14.

¹² Id. at 14-15.

¹³ Id. at 15.

CSXT argues that DuPont has not proven qualitative market dominance for the two plasticizer movements.¹⁴ CSXT asserts that truck transportation is a feasible alternative to rail and that it represents effective competition to CSXT.¹⁵ CSXT states that DuPont has repeatedly represented in negotiations that truck transportation is competitive for these movements and that DuPont could realize significant cost savings by switching to trucks, particularly in car ownership and lease costs, cleaning and maintenance costs, inventory costs, and labor costs.¹⁶ CSXT argues that DuPont has not supported its contentions that truck is more costly than rail.¹⁷ CSXT maintains that DuPont has failed to account for potential savings that would be realized in switching from rail to truck to transport this commodity.¹⁸

CSXT argues that both of these movements have transloading alternatives.¹⁹ CSXT also asserts that the risk of contamination during the transloading of plasticizers is minimal, citing data from its subsidiary Transflo Terminal Services, Inc. (Transflo) that shows a contamination rate of only .007% in the transloading of various bulk products from rail car to truck.²⁰ CSXT provides transload cost estimates and argues that transloading options represent effective competition to the service that CSXT currently provides.²¹ CSXT also argues that there is geographic competition for the Washington movement given that all plasticizer traffic has been tendered via the Duart lane since October 2007.

On rebuttal, DuPont asserts that its statements during negotiations that it could switch to trucks to lower costs were merely posturing and did not reflect actual evidence of intermodal competition from motor carriers.²² DuPont maintains that the transload statistics of Transflo regarding bulk products offer no relevant assessment of the true risk of contamination for products such as liquid plasticizers, which are especially subject to contamination due to their physical characteristics.²³ DuPont also argues that CSXT did not identify the nature of the commodities Transflo analyzed or clarify whether Transflo had any actual experience transloading plasticizers.²⁴ DuPont asserts commodities with characteristics similar to plasticizers are not likely to travel by truck, and that the Transflo statistics likely reflect under-

¹⁴ CSXT Reply at 4.

¹⁵ Id.

¹⁶ Id. at 4-5.

¹⁷ Id. at 6.

¹⁸ Id. at 8.

¹⁹ Id. at 7.

²⁰ Id. at 5.

²¹ Id.

²² DuPont Rebut. at 15.

²³ Id. at 12.

²⁴ Id. at 11.

reporting of contamination incidents.²⁵ DuPont also argues on rebuttal that CSXT did not provide sufficient support for the hypothetical transload alternatives and states that the tariff rates it has obtained from the other rail carrier are significantly higher than CSXT's rates for these movements.²⁶

2. Analysis

Effective competition refers to competition that is adequate to restrain rates to a reasonable level.²⁷ The mere physical possibility of transporting plasticizers by truck does not mean that there is effective competition. The record is clear that DuPont has never shipped plasticizers by truck for the Duart or Washington movements. Moreover, the record supports the conclusion that there is a high risk of contamination when plasticizers are shipped by truck – a conclusion which CSXT's generalized analysis of unidentified bulk products does not rebut. The fact that DuPont threatened in prior contract negotiations that it might switch to truck is not dispositive, where, as here, the evidence does not suggest that such a switch would be feasible or economical.²⁸

We will not consider CSXT's geographic competition argument for the Washington movement. In Simplified Standards, we reiterated the Board's well-settled policy not to consider evidence relating to possible product or geographic competition.²⁹

In sum, we find that CSXT has market dominance with respect to the Duart and Washington movements.

Amphill Movement

1. Position of the Parties

DuPont argues that CSXT faces no effective intermodal competition for the Amphill movement of synthetic plastic powder.³⁰ According to DuPont, CSXT is the only rail carrier that serves the origination point of Amphill, and there is no water carriage alternative to CSXT for

²⁵ Id.

²⁶ Id. at 20.

²⁷ See Market Dominance Determinations, 365 I.C.C. at 129; see also Arizona Public Service Co. v. United States, 742 F.2d 644, 651 (D.C. Cir. 1984) (Congress intended that reasonable rates are those that competitive pressures would ensure).

²⁸ See FMC Wyoming Corp. & FMC Corp. v. Union Pacific RR Co., 4 S.T.B. 699, 718 (2000) (dismissing statements made during the course of negotiations as posturing).

²⁹ Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1), slip op. at 22 (STB served Sept. 5, 2007); see also Market Dominance Determinations, 5 S.T.B. 492 (2001), aff'd sub. nom. Assoc. of American Railroads v. Surface Transp., 306 F.3d 1108 (2002).

³⁰ DuPont Open. at 10.

these movements.³¹ Further, DuPont asserts that trucking does not offer effective competition to the transportation of plastic powder by rail.³² DuPont states that it does occasionally ship plastic powder by truck, but only when there is a particular need for faster and more reliable service than CSXT is able to offer.³³ According to DuPont, only 13.6% of the total volume of synthetic plastic powder it shipped between this origin and destination in 2006 was trucked.³⁴ Most of that volume was shipped over lanes that do not have a rail option, with only 2.4% being trucked where there was a rail option.³⁵ DuPont states that there are some circumstances where the variability in CSXT's average transit time forces DuPont to expedite synthetic plastic powder shipments to Wyandotte in order to allow its customer to meet its production schedule.³⁶ DuPont points to its shipment logs as proof of this pattern, which show that DuPont goes months without any truck movements of plastic powder and then often bunches several truck shipments over a 1- or 2-day timespan.³⁷

DuPont argues that the cost of trucking plastic powder for this origin/destination pair is significantly higher than the cost of rail transportation, even after considering CSXT's recent rate increase and additional car lease and maintenance costs.³⁸ Additionally, DuPont states that its customer prefers to receive plastic powder by rail for a variety of reasons related to the physical characteristics of the commodity.³⁹ DuPont explains that synthetic plastic powder has a very low melting point, necessitating special equipment and techniques to load and unload it, making delivery by truck a disfavored alternative.⁴⁰ DuPont argues that these factors weigh against a finding of effective competition by motor carrier.⁴¹

CSXT argues that DuPont has failed to prove that truck transportation is not a competitive alternative to CSXT's rail service for the Amptill movement.⁴² CSXT maintains that truck costs are not significantly higher than rail costs and argues that DuPont overstates the

³¹ Id. at 9-10.

³² Id. at 15.

³³ Id. at 17.

³⁴ Id. at 16-17.

³⁵ Id.

³⁶ Id.

³⁷ Id. at 17.

³⁸ Id. at 17-18.

³⁹ Id. at 18-19.

⁴⁰ Id.

⁴¹ Id. at 20.

⁴² CSXT Reply at 8.

difference between CSXT's line-haul rates and truck transportation.⁴³ CSXT also alleges that there is a cost-competitive transloading option for this movement.⁴⁴

On rebuttal, DuPont argues that it would be impossible to shift sufficient volumes of synthetic plastic powder to truck to obtain a sufficiently low line-haul rate to offer effective competition for rail.⁴⁵ DuPont also argues that the transloading option that CSXT identified is not economically feasible.⁴⁶

2. Analysis

Although trucks are used occasionally to move the plastic powder between this origin and destination, the record evidence leads us to conclude that trucking does not provide effective competition for this movement. We considered a number of factors in reaching this decision. First, DuPont employs trucks infrequently, only when CSXT cannot deliver the product in as timely a fashion as the customer demands. Evidence that a small volume of the issue traffic moves on an alternate mode does not, by itself, mean that there is effective competition.⁴⁷ There must be "considerable competitive pressures" resulting from handling of a "meaningful portion" of the total volume for there to be effective intermodal competition.⁴⁸ Second, the physical characteristics of the plastic powder and customer preference also illustrate the infeasibility of trucking as an alternative to rail. Third, while CSXT has argued that there may be a transloading alternative to CSXT's direct service, it has not produced convincing evidence on this record to rebut DuPont's showing that transloading is not a competitive constraint on rail rates due to price differentials, customer preference, and the lack of specialty equipment needed for carriage of synthetic powder plastics by truck.

We also have reviewed the conflicting evidence submitted by the parties regarding the cost difference between rail and truck for shipping the plastic powder. There appears to be no dispute that truck service is at least 10% more expensive than rail service for this movement, even after the CSXT rate increase. Even if we were to find that the cost of trucking the product is similar to the cost of using rail after the CSXT rate increase, it does not follow that the threat of trucking is evidence of effective competition. After all, even a monopolist finds that there is a profit-maximizing price beyond which it cannot raise prices without adversely affecting its bottom line. A carrier possessing market power might set its rates so high that it would begin to lose business to a higher-cost alternative (such as a trucking company).⁴⁹ As the Board has

⁴³ Id. at 9-10.

⁴⁴ Id. at 10.

⁴⁵ DuPont Reb. at 23.

⁴⁶ Id. at 26.

⁴⁷ Aluminum Assn, Inc., et al. v. ACY R. Co., et al., 367 I.C.C. 475 (1983).

⁴⁸ Id. at 483-84.

⁴⁹ See FMC Wyoming Corp. & FMC Corp. v. Union Pacific RR Co., 4 S.T.B. 699, 718 & n.38 (FMC) (Board noted that a monopolist will raise prices so long as it is profitable to do so (continued . . .))

previously noted, while this may create an “outer limit” constraint, it does not necessarily mean that effective competition is present.⁵⁰

A final factor we have considered is the level of the challenged rate itself, which is 380% of the variable cost of providing rail service. Evidence that rail revenues substantially exceed variable costs by itself does not indicate market dominance. 49 U.S.C. 10709(d)(2)(A) (a finding that a rate exceeds 180% of variable cost does not establish a presumption of market dominance). But when, as here, those data are supported by other evidence, it may serve to buttress a finding of market dominance and allow us to examine whether the rail rates are restrained to a level that is reasonable for that traffic.⁵¹

In sum, weighing all of the evidence, we find that CSXT has market dominance with respect to the Ampthill movement.

RATE REASONABLENESS STANDARDS

Under the Three-Benchmark method, the reasonableness of the challenged rate is addressed by examining the R/VC ratio that is produced by the challenged rate in relation to three benchmark figures, each of which is also expressed as an R/VC ratio. The first benchmark, the Revenue Shortfall Allocation Method (RSAM), measures the average markup over variable cost that the defendant railroad would need to charge all of its “potentially captive” traffic (traffic priced above the 180% R/VC level) in order for the railroad to earn adequate revenues as measured by the Board under 49 U.S.C. 10704(a)(2). The second benchmark, $R/VC_{>180}$, measures the average markup over variable cost currently earned by the defendant railroad on its potentially captive traffic. The third benchmark, the R/VC_{COMP} , is used to compare the markup being paid by the challenged traffic to the average markup assessed on other comparable potentially captive traffic.

(. . . continued)

and concluded that “the fact that [carrier] matches prices set by alternatives with significantly higher costs, while maintaining a dominant market share, is not enough to demonstrate effective competition for the traffic at issue.”); see also Arizona Pub. Serv. Co. v. United States, 742 F.2d 644, 650-51 (D.C. Cir. 1984) (mere existence of alternative does not in itself constrain the railroads from charging rates unreasonable rates).

⁵⁰ See FMC at 718 (“[An] alternative does impose an outer limit on the rate that [a carrier] can charge, although [the carrier] can exercise considerable market power before reaching that outer limit. In other words, there is a competitive constraint, even though there is not effective competition.”) (footnote omitted); see also Arizona Pub. Serv. Co., at 651 (noting that at some rail price point, competitive pressure from a horse and buggy or people carrying commodities in buckets prevents a railroad from raising its rates beyond an “outer bound”).

⁵¹ McCarty Farms, et al. v. Burlington Northern Inc., 3 I.C.C.2d 822, 832 (1987), remanded on other grounds, Burlington Northern R. Co. v. ICC., 985 F.2d 589 (D.C. Cir. 1993).

Once we select the appropriate comparison group for the R/VC_{COMP} benchmark(s), each movement in the comparison group is adjusted by the ratio of $RSAM \div R/VC_{>180}$. We then calculate the mean and standard deviation of the resulting R/VC ratios (weighted in accordance with the appropriate sampling factors). If the challenged rate is above a reasonable confidence interval around the estimate of the mean for the adjusted comparison group, it is presumed unreasonable and, absent any “other relevant factors,” the maximum lawful rate is prescribed at that boundary level.

THREE-BENCHMARK ANALYSIS

A. R/VC_{COMP} Benchmark

1. *Comparability Factors*

The purpose of the R/VC_{COMP} benchmark is to use the R/VC ratios of comparable traffic as evidence of the reasonable R/VC levels for traffic of that sort. Comparability is determined by reviewing a variety of factors, such as length of movement, commodity type, traffic densities of the likely routes involved, and demand elasticity (although the comparison group need not have movements with identical demand). Movements with different cost characteristics may be included in the comparison group, because what we are comparing are the mark-ups over variable cost to determine the reasonable level of contribution to joint and common costs for a particular movement. The comparison group should consist of only captive traffic over which the carrier has market power, as the rates available to traffic with competitive alternatives would provide little evidence on the degree of permissible demand-based differential pricing needed to provide a reasonable return on the investment. Thus, no movements priced below the 180% R/VC level may be included in the comparison group.

2. *Comparison Group*

DuPont and CSXT simultaneously tendered their initial evidence regarding appropriate comparison groups. On reply, each party then tendered its “final offer” groups of movements it believed should comprise the comparison groups.⁵² In simultaneous rebuttal filings, the parties presented their arguments challenging the other party’s comparison groups and supporting their own.

In selecting the comparison group to use, we must decide which group is more similar in the aggregate to the relevant issue movement. This is an “either/or” selection, with no modifications by the Board. We reviewed each movement individually, assessing whether the comparison groups consisted of commodities and operating characteristics that were similar to

⁵² Under Simplified Standards, at 18, only movements that had previously been submitted by one of the parties in its initial tender can be included in the final offer groups. Any movement set forth in both sides’ initial tenders is required to be included in each side’s final comparison group, unless the parties agreed to exclude the movement.

the issue movements. For the reasons discussed below, we select DuPont's comparison groups for each of the three movements at issue in this proceeding.

Although the parties used differing comparability factors in their opening submissions, on reply—when the parties submitted their final tender offers—they had come to agreement on most of the comparability factors that should be used.⁵³ Specifically, in their final tender offers, the parties applied the following selection criteria: include only traffic that had R/VC ratios above 180%; include only traffic moving in the same car type (private tank cars for plasticizers, and private covered hopper cars for plastics); exclude the issue traffic;⁵⁴ include only traffic that is “local” to CSXT (i.e., no other rail carrier participates in the movement); include only traffic moving a similar distance;⁵⁵ and include only traffic of comparable commodities.⁵⁶

The only significant factor on which the parties disagree involves fuel surcharges. DuPont included both movements where a fuel surcharge was imposed and movements where it was not. CSXT, in contrast, included only movements where a fuel surcharge was imposed.

CSXT contends that the movements to which it applies a fuel surcharge are more likely to reflect the same market dynamics as the issue traffic.⁵⁷ CSXT claims that rates without the fuel surcharge were negotiated pursuant to an arrangement under which, due to market and commercial factors, CSXT agreed to forgo a fuel surcharge.⁵⁸ CSXT thus argues that, because there are market-based reasons why fuel surcharges exist only on some movements, those same

⁵³ The parties' ultimate agreement on the majority of comparability factors demonstrates the effectiveness of the final tender selection process.

⁵⁴ Although both parties agree to exclude issue traffic from the comparison groups, they disagree on how to do so. DuPont would exclude the issue origin-destination movement from the comparison group for that movement only, whereas CSXT would exclude the issue origin-destination movements from the comparison groups altogether. Whether or not those movements are included does not materially affect the selection of DuPont's comparison groups.

⁵⁵ The parties agree generally on how to calculate distance. However, DuPont took the length of haul for the issue movement, rounded to the nearest 50 miles, and then selected movements within a range of 150 miles on each side. CSXT objects to rounding the mileage of the issue movement. Additionally, CSXT uses the actual loaded miles of the issue traffic movement, while DuPont uses the estimated miles from the Waybill Sample. We use the actual length of haul for calculating the issue movements' distance. But the minor rounding dispute is immaterial. Even if we were inclined to agree with CSXT, we would select DuPont's comparison groups in any event because of the more significant differences over the role of fuel surcharges.

⁵⁶ DuPont Reply at 15; CSXT Reply at 14-16.

⁵⁷ CSXT Reply at 28.

⁵⁸ Id. at 29.

market conditions should be reflected in the comparison group by excluding non-fuel-surcharged movements.⁵⁹

DuPont notes that, in Rail Fuel Surcharges, STB Ex Parte No. 661 (STB served Jan. 26, 2007), the Board concluded that carriers, including CSXT, may have been over-recovering fuel costs on traffic that was subject to a fuel surcharge. DuPont argues that, because of this possible over-recovery, movements with a fuel surcharge ideally should be *excluded* from the comparison groups. But DuPont notes that, if the comparison groups were limited to only movements without a fuel surcharge, then the groups might possibly reflect an under-recovery of fuel costs.⁶⁰ Accordingly, DuPont argues that both movements with a fuel surcharge and movements without such a surcharge should be included in the groups, and that together, any over-recoveries and under-recoveries from these movements should be offset.⁶¹

In this case, we do not believe that the presence or absence of a fuel surcharge would be an appropriate selection criterion for the comparison group. In Rail Fuel Surcharges, we addressed the fuel surcharge programs then used by CSXT and other rail carriers, in which the surcharge was computed as a percentage of the base rate. We explained that, because railroads rely on differential pricing, under which rate levels can be dependent on factors other than costs, a surcharge that is tied to the level of the base rate cannot fairly be described as merely a cost recovery mechanism. Rail Fuel Surcharges at 6. We explained that two shippers' traffic may use an identical amount of fuel, but if one started out with a higher base rate (because it is captive), it would pay dramatically more in fuel surcharges. In those circumstances, the fuel surcharge program could be forcing captive shippers with higher base rates to cross-subsidize the fuel costs of shippers with lower base rates. Accordingly, we found the fuel surcharge programs in place at that time to be an unreasonable practice and directed the carriers to modify their programs.

Here, if we were to compare the issue movements to a comparison group comprised solely of movements with a fuel surcharge that was calculated as a percentage of the base rate, the comparison groups (composed of potentially captive traffic with high base rates) could reflect a collective over-recovery of fuel costs. Because we concluded that captive traffic that was incurring these surcharges was likely cross-subsidizing the fuel costs of other, non-captive traffic, the railroad is effectively arguing here for the comparison groups to be limited to movements that are cross-subsidizing the fuel costs of other movements. We conclude that comparison groups that consist of movements both with and without a fuel surcharge provide a

⁵⁹ CSXT Reb. at 12-14.

⁶⁰ DuPont also questions whether CSXT was actually forgoing recovery of its fuel costs on movements where no fuel surcharge was imposed, and thus whether there would in fact be an under-recovery. DuPont's witness asserts that the fuel cost was being recovered in the Rail Cost Adjustment Factor that railroads use to adjust their rates. DuPont Reb. V.S. of Crowley at 15-16.

⁶¹ DuPont Reb. at 30.

better aggregate picture of the reasonable contribution to joint and common costs that the issue movements should bear.⁶² Accordingly, we use DuPont's comparison groups in our analysis.

B. RSAM and R/VC_{>180} Benchmarks

The R/VC_{>180} benchmark measures the average markup over variable cost currently earned by the defendant railroad on its potentially captive traffic. The RSAM benchmark measures the average markup above variable cost that the carrier would need to charge its potentially captive traffic to meet its revenue needs. In accordance with Simplified Standards, we use the following formula to calculate RSAM:

$$\text{RSAM} = (\text{REV}_{>180} + \text{REV}_{\text{short/overage}}) \div \text{VC}_{>180}$$

where REV_{>180} is an estimate of the total revenue earned by the carrier on potentially captive traffic, and VC_{>180} is an estimate of the total variable costs of the railroad to handle that traffic. (The confidential Waybill Sample is used to estimate these components.) To calculate RSAM, we add to the numerator the carrier's revenue shortfall (or subtract any overage) as shown in our annual revenue adequacy determination (REV_{short/overage}). In applying the Three-Benchmark approach, the ratio of the two benchmarks is used to adjust the R/VC ratios of the selected comparison group. Thus, the relationship between RSAM and R/VC_{>180} serves as a revenue need adjustment factor, when applied to comparison group movements, to reflect demand-based differential pricing principles.⁶³

The RSAM and R/VC_{>180} benchmarks are published annually by the Board. In this case, the parties used the benchmark figures for the years 2002 through 2005, which were published in Rate Guidelines—Non-Coal Proceedings, STB Ex Parte No. 347 (Sub-No. 2) (STB served Apr. 25, 2006). Both parties ask us to modify those published figures here.

CSXT argues that the RSAM benchmarks are too low because the RSAM formula fails to incorporate the effect of taxes. As observed by CSXT, the RSAM formula proposed and adopted in Simplified Standards uses a revenue shortfall (REV_{short/overage}) that is calculated on an after-tax basis, while REV_{>180} is calculated on a pre-tax basis.⁶⁴ CSXT argues that the RSAM calculation must take into account not just the additional revenue that a carrier would need to earn to achieve revenue adequacy, but also the taxes it would need to pay on that revenue. CSXT proposes that we change the RSAM formula to use a pre-tax revenue shortfall that includes both state taxes and the statutory federal tax rate of 35%, which would raise the RSAM benchmark.

⁶² We offer no opinion on whether this might be a more reasonable selection criteria in future cases where the movements in the Waybill Sample are subject to a different fuel surcharge program.

⁶³ See Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. 1004, 1042 (1996).

⁶⁴ CSXT Open. at 23.

In contrast, DuPont argues that the RSAM benchmarks are too high, because they rely on the Board's cost-of-capital calculations for 2002 through 2005, which DuPont argues are overstated. We have recently changed the methodology used to calculate the rail industry's cost of capital, adopting a Capital Asset Pricing Model (CAPM) for the 2006 cost-of-capital determination.⁶⁵ DuPont contends that we should recalculate RSAM to reflect the new cost-of-capital methodology in this case. It argues that all of the inputs to develop a cost of capital based on the new methodology are readily available and easy to apply and that the cost of capital is central to the calculation of RSAM and $R/VC_{>180}$.

We note that, paradoxically, each party objects to the other's proposed changes to RSAM as inappropriate to make in the context of an individual rate case handled under the Simplified Standards. The Simplified Standards are designed to sacrifice some precision in the rate analysis in order to have an expedited, simplified, and less costly process to resolve smaller rail rate disputes. DuPont notes that CSXT did not point out the tax problem with RSAM during the four rounds of pleadings in Simplified Standards, in which the Board considered changes to its RSAM methodology.⁶⁶ Thus, DuPont argues that if CSXT wishes to challenge the RSAM methodology, it may only do so in a petition to reopen Simplified Standards.⁶⁷ Similarly, CSXT argues that DuPont's proposed recalculation would constitute a retroactive application of the new cost-of-capital method and that an individual rate case, particularly one handled under the streamlined procedures of Simplified Standards, is not the proper forum to consider such a far-reaching change.

DuPont also objects to the manner in which CSXT proposes to change the RSAM benchmarks. CSXT would use the statutory tax levels. DuPont argues that RSAM should be adjusted using CSXT's "effective tax rate," i.e., the level of taxes that CSXT actually pays.⁶⁸ DuPont further argues that there is a countervailing adjustment that should also be made. It claims that URCS overstates the tax component in the variable costs of movements because it includes a cost for taxes based on the statutory tax rate, not the carrier's effective rate. DuPont

⁶⁵ See Methodology to be Employed in Determining the Railroad Industry's Cost of Capital, STB Ex Parte No. 664 (STB served Jan. 17, 2008).

⁶⁶ CSXT seeks to excuse its failure to draw this issue to the Board's attention in the rulemaking proceeding due to a lack of access to the Board's workpapers. CSXT Reb. at 30-31. However, the Board made it clear at the outset of that proceeding that the RSAM proposal would use a revenue shortfall ($REV_{\text{short/overage}}$) that would be calculated on an after-tax basis. See Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1), slip op. at 24 (STB served July 28, 2006) (illustrating the RSAM proposal for one carrier); Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1), slip op. at 4 (STB served Oct. 20, 2006) (Table 1) (illustrating RSAM proposal for all Class I carriers). Moreover, since it was originally adopted in 1996, the RSAM formula has never addressed taxes, and CSXT has had over a decade to present its proposal to the agency for broader consideration.

⁶⁷ DuPont Reply at 30-31.

⁶⁸ Id. at 28-29, V.S. of Crowley at 33-35.

argues that this overstatement results in too few movements being shown to have R/VC ratios greater than 180% and that it affects both the RSAM and $R/VC_{>180}$ benchmarks.⁶⁹

It appears that the changes proposed by the parties would largely offset each other. However, even if that were not the case, we would not make any adjustments here, as this is not the proper forum for collateral attacks on the Board's methodology. The Three-Benchmark method was intended to serve as a simplified and expedited tool to evaluate the reasonableness of a challenged rate based on the Board's existing measures of the rail industry. The hallmark of this approach is the reliance on prior Board findings to expedite and simplify the rate reasonableness determination. Two of the three key benchmarks are pre-determined by the agency on an annual basis. Those benchmarks in turn rely on our annual cost-of-capital and revenue-adequacy determinations. We also rely on use of our Uniform Rail Costing System and data from the STB Carload Waybill Sample (Waybill Sample).⁷⁰ Considerable effort is expended by this agency in making each of these findings, and by doing much of the work in advance (and then relying on those findings in the Three-Benchmark approach), we offer shippers with smaller rate disputes a practical means of obtaining expedited relief.

Making the adjustments proposed by the parties would go well beyond the intended scope of an individual simplified rate proceeding. The complexity of allowing the parties to litigate the appropriate methodologies to be applied in an individual proceeding (such as challenging prior Board findings on issues like the cost of capital, revenue adequacy, or RSAM; challenging the information contained in the Waybill Sample; or challenging the URCS model) would quickly consume the cases and inevitably lead to protracted litigation. Accord Simplified Standards at 84 (no evidence on movement-specific adjustments to URCS allowed); at 22 (no evidence of product or geographic competition allowed); at 83 (evidence on comparability must be drawn only from the Waybill Sample or other publicly available sources).

The proper forum for considering these methodological issues is in an appropriate rulemaking proceeding, where we can obtain the benefit of broader public input.⁷¹ Accordingly, we have instituted a rulemaking proceeding, in STB Ex Parte No. 646 (Sub-No. 2), to obtain public comments on whether and how to change the RSAM formula to reflect taxes. In the meantime, we will use the formula adopted in Simplified Standards.

⁶⁹ DuPont Reply at 29-30; V.S. of Crowley at 35-36.

⁷⁰ The Waybill Sample is a stratified sample of carload waybills for terminated shipments by railroad carriers.

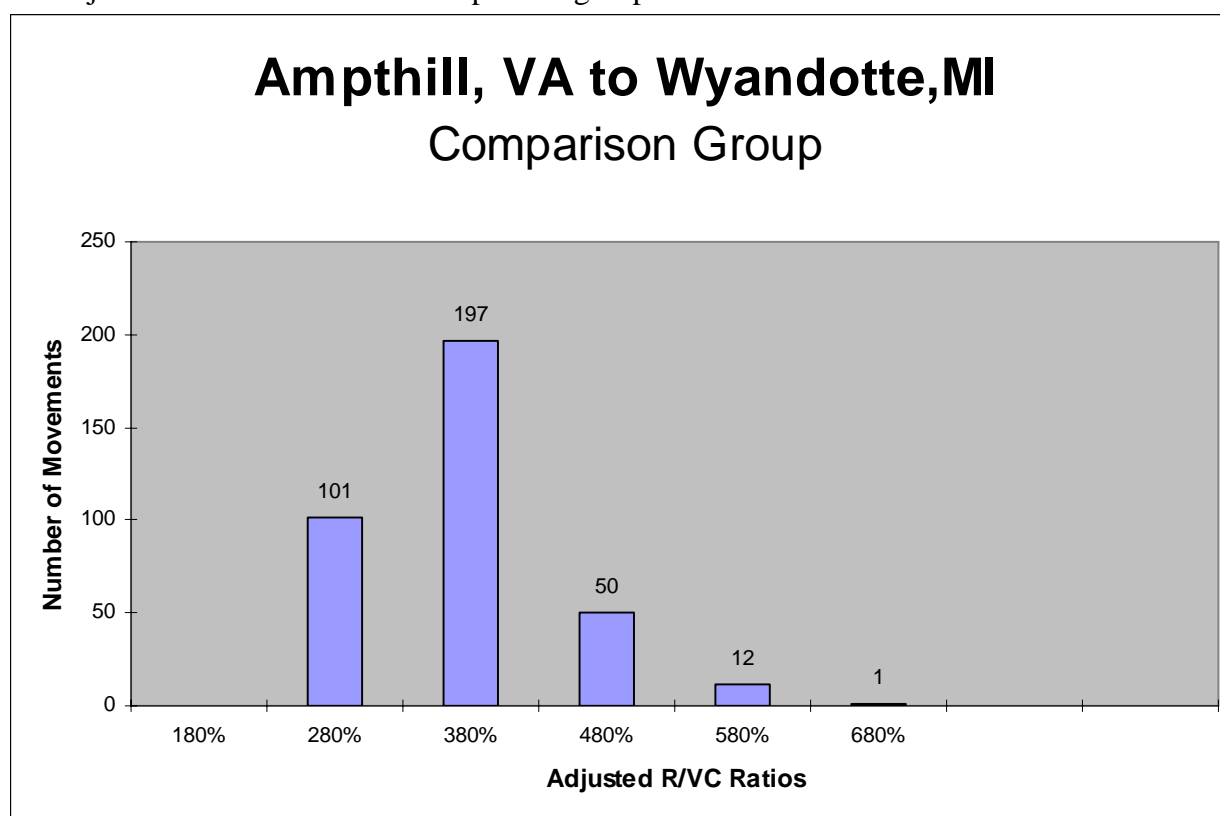
⁷¹ CSXT contends that it is appropriate to make its proposed adjustment to RSAM here because "it simply seeks to correct an inadvertent error in the calculation of the RSAM," in contrast to DuPont's proposal, which "would make wholesale organic changes to the RSAM." CSXT Reb. at 31 n.24. We do not agree with CSXT's characterization of its own proposal. This is not a simple mathematical error in the implementation of the RSAM formula adopted in Simplified Standards. Rather, CSXT proposes that we use a *different* RSAM formula, one that increases the shortfall to include taxes.

It would be premature to initiate a rulemaking to consider the cost-of-capital issue raised by DuPont. The changes proposed by DuPont are premised on using CAPM alone. However, we are currently in the process of exploring whether to instead use an average of the CAPM figure and a multi-stage discounted cash flow (DCF) model.⁷²

For all of these reasons, we rely here on the RSAM and $R/VC_{>180}$ benchmark calculations as published in Rate Guidelines—Non-Coal Proceedings, STB Ex Parte No. 347 (Sub-No. 2) (STB served Apr. 25, 2006).

C. Rate Reasonableness Presumption

Having selected DuPont's comparison groups through the final-tender process described above, we adjust each movement in the comparison groups by the ratio of $RSAM \div R/VC_{>180}$.⁷³ The adjusted R/VC ratios of the comparison groups are illustrated below.⁷⁴

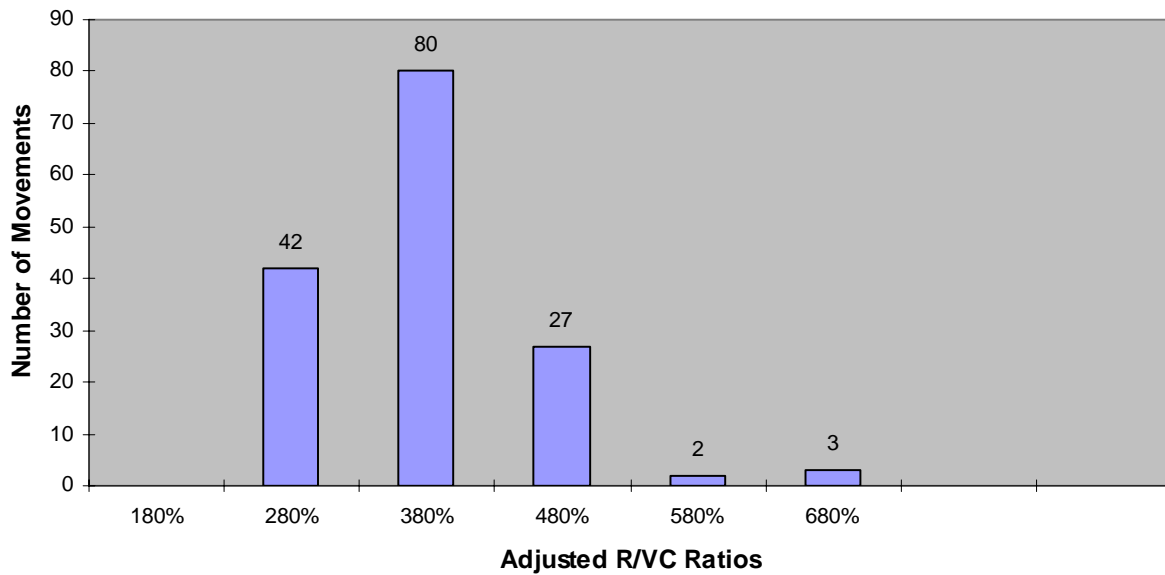


⁷² See Use Of A Multi-Stage Discounted Cash Flow Model In Determining The Railroad Industry's Cost Of Capital, STB Ex Parte No. 664 (Sub-No. 1) (STB served Feb. 11, 2008).

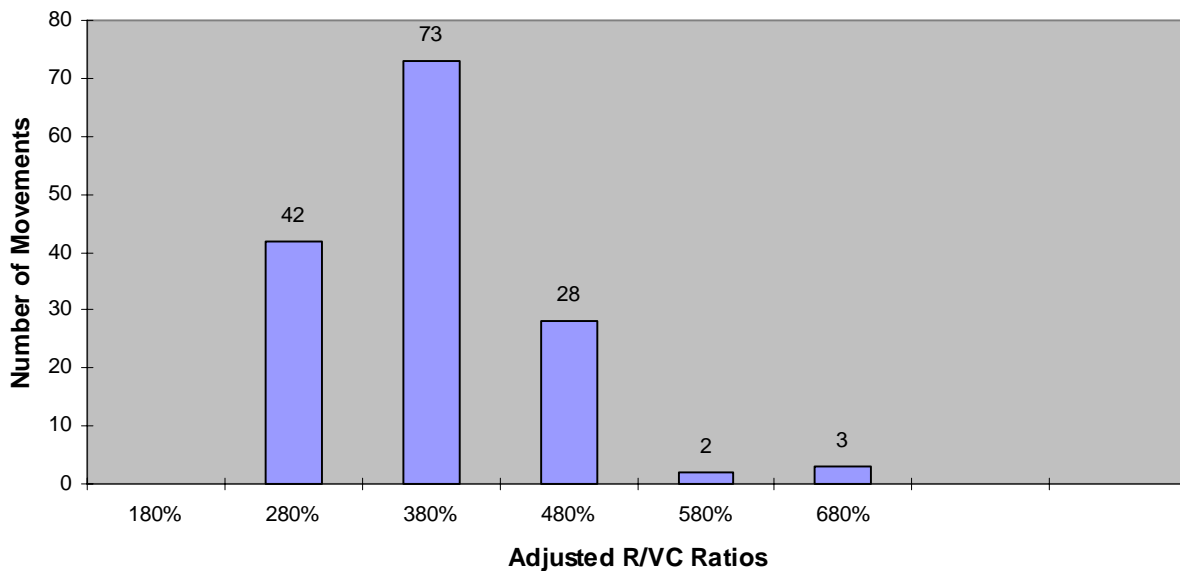
⁷³ In this case, $RSAM \div R/VC_{>180}$ equals 1.24.

⁷⁴ The histograms count the number of data points between the current bin number and the adjoining higher bin. A number is counted in a particular bin if it is equal to or less than the bin label. All values below the first bin value label are counted together, as are the values above the last bin value label.

Heyden, NJ to Duart, NC Comparison Group



Heyden, NJ to Washington, WV Comparison Group



We then calculate the mean and standard deviation of the R/VC ratios for the adjusted comparison groups (weighted in accordance with the proper sampling factors). In this case, the mean R/VC ratio of the 361 movements in the adjusted comparison group for the Amptill movement is 324% R/VC and the standard deviation is 0.693. The mean R/VC ratio of the 154 movements in the adjusted comparison group for the Duart movement is 324% R/VC and the standard deviation is 0.774. The mean R/VC ratio of the 148 movements in the adjusted comparison group for the Washington movement is 324% R/VC and the standard deviation is 0.796.

Using the mean (R/VC_{COMP}) and standard deviation (S) of the adjusted comparison group, along with the number of movements in the comparison group (n), the upper boundary of a reasonable confidence interval around the estimate of the mean is derived as follows:⁷⁵

$$\text{upper boundary} = R/VC_{COMP} + t_{n-1} \times (S \div (n-1)^{1/2})$$

This confidence interval is a function of the number of movements in the comparison groups and the standard deviation of those adjusted R/VC ratios. In this case, the upper boundary is 329% R/VC for the Apthill movement, 332% R/VC for both the Duart movement and the Washington movement. As the challenged rates are above this boundary, they are presumed unreasonable and, absent any “other relevant factors,” the maximum lawful rates will be prescribed at those levels.

D. Other Relevant Factors

Under the Three-Benchmark method, either party may submit evidence of “other relevant factors” to demonstrate that the maximum lawful rate should be higher or lower. Parties are required to quantify the impact of these “other relevant factors” on the maximum lawful rate.

In this case, both parties introduced evidence of “other relevant factors” which they argue should lower (according to DuPont) or raise (according to CSXT) the maximum lawful rate level. Their evidence is discussed below.

1. Regulatory Lag

CSXT would have us take into account the regulatory lag between the 2002-2005 Waybill Sample data and the challenged 2007 rates by adjusting the Waybill Sample R/VC levels to 2007 levels. CSXT maintains that this adjustment is necessary because of significant market changes and dynamics (including increasing demand and tightening capacity) and

⁷⁵ This formula for a confidence interval around a mean can be found in most statistics textbooks. We use a “one-sided” hypothesis test, such that we can have 90% confidence as to whether the challenged rate exceeds a reasonable norm. A 90% confidence interval is a standard level of confidence used in statistical analysis. The parameter t_{n-1} will range from 3.078 to 1.28 depending on the number of movements in the comparison group. In this case, the parameter t_{n-1} equals 1.28 for all three comparison groups (when rounded).

railroad cost inflation for shipments of chemical traffic that have occurred over the last 5 years. CSXT would have us adjust revenues by publicly available data or, alternatively, by using current revenue information for chemicals traffic produced during discovery. It would have us adjust costs by using publicly available data and the indexing methods used in stand-alone cost cases. CSXT's proposed adjustments would have the effect of raising the R/VC ratios in the comparison groups. DuPont objects to these proposed adjustments.

In Simplified Standards, at 84-85, we addressed the issue and discussed problems associated with making adjustments to the comparison group's R/VC ratios to account for the lag in the data. First, we explained that in an R/VC ratio, price levels in the economy are reflected both in the numerator and denominator. Thus, the effects of price shifts on revenues should be largely offset by inflationary increases in costs, leaving the R/VC ratios generally unaffected. Moreover, the expansion ratio ($RSAM \div R/VC_{>180}$) will also reflect price shifts, creating an offsetting effect to any rate increase or decrease that could be attributable to regulatory lag.

We note that, even though it would adjust the R/VC ratios in the comparison group, CSXT would apply the expansion ratio ($RSAM \div R/VC_{>180}$) based on the 2002-2005 cost and revenue data. But if one were to apply similar adjustments to the R/VC ratios in the expansion ratio, RSAM (the numerator) would likely decrease. That is because a carrier with higher R/VC ratios from competitive traffic would require less revenue from its potentially captive traffic to achieve revenue adequacy. On the other hand, the $R/VC_{>180}$ benchmark (the denominator) would likely increase as a result of the higher R/VC ratios. Thus, CSXT's proposed adjustments that would lead to higher R/VC ratios in the comparison group, indexed to 2007 levels, should also produce a lower expansion ratio.

We expressed concerns about an apple-to-oranges adjustment in Simplified Standards (at 84-85). Consider a hypothetical example where a carrier was revenue adequate in 2006, such that the $RSAM \div R/VC_{>180}$ ratio shows the carrier earning 5% more from its potentially captive traffic than would be needed to earn adequate revenues in that time period. In that situation, the expansion ratio would serve to reduce the R/VC ratios of the comparison group in 2006 by 5% to more accurately reflect reasonable rates. Assume further that the carrier had increased all revenues by 10% between 2006 and 2007. It does not follow that the comparison group R/VC ratios should be adjusted upward by 10%, as those R/VC ratios would already provide the carrier more than needed to achieve adequate revenues in 2006 and there is no evidence to suggest that higher rates would be proper. In fact, in this hypothetical, the evidence would suggest that an opposite adjustment should be made. That is, if a revenue adequate carrier had been raising rates, then it would need less (not more) differential pricing of potentially captive traffic. When the 2007 information becomes available, the RSAM and $R/VC_{>180}$ benchmarks for 2007 would change accordingly and suggest that the comparison group R/VC levels should be adjusted downward, not upward as sought by the carrier.

Because CSXT's proposed adjustment would be incomplete, the maximum rate level based on this adjustment would be too high. Accordingly, CSXT has failed to meet its burden of demonstrating that its proposed adjustment is appropriate.

2. *Managerial Inefficiency*

DuPont argues that we should adjust the presumed maximum rate downward to give due consideration to the “Long-Cannon” factors at 49 U.S.C. 10701(d)(2)(A)-(C), particularly: (1) the amount of traffic which is transported at revenues which do not contribute to going concern value; and (2) the amount of traffic which contributes only marginally to fixed costs and the extent to which rates on such traffic can be changed to maximize the revenues from that traffic.⁷⁶ Specifically, DuPont would have us apply the efficiency adjustment described in Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. 1004, 1027-1030 (1996) (Simplified Guidelines), to exclude from the RSAM calculation the revenue shortfall from traffic with an R/VC ratio below 100%.⁷⁷ CSXT maintains that DuPont has not justified such an RSAM adjustment as an “other relevant factor,” citing BP Amoco Chemical Company v. Norfolk Southern Railway Company, STB Docket No. 42093 (STB served June 6, 2005) and the Notice of Proposed Rulemaking in Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served July 28, 2006).⁷⁸

However, URCS is not a measure of short-run variable costs or the marginal cost of hauling rail traffic. Rather, it is a measure of intermediate variable costs, on a system-average basis, that includes costs (such as return on road property investment) that are fixed in the short term. Thus, an R/VC ratio below 100% does not necessarily reflect improper pricing or a money-losing service. See Simplified Guidelines at 1028. Competition from other railroads or other modes of transportation may force a carrier to price traffic below the measure of long-run variable costs from URCS.

DuPont argues that, as carriers are nearing capacity, there should no longer be any traffic with a revenue contribution below variable cost as calculated by URCS. Whether or not that is the case, the mere fact that a movement may be priced below URCS variable costs—an intermediate/long-run variable cost measure—does not mean that the revenues from the movement do not contribute to going concern value, which is a short-run cost measure.

By treating all movements with revenue below URCS variable costs as resulting from managerial inefficiency on the part of CSXT, DuPont has vastly overstated the likely degree of such pricing inefficiency. Accordingly, DuPont has failed to meet its burden of demonstrating that its proposed adjustment is appropriate.

E. Maximum Rate Determination

As neither party has carried its burden of demonstrating “other relevant factors” to raise or lower the presumptive maximum lawful rates, we will prescribe the maximum lawful rates for the issue movements at the levels produced by our formula, which in this case are R/VC ratios of

⁷⁶ DuPont Open. 31-33.

⁷⁷ Id.

⁷⁸ CSXT Reply 47-49.

not more than 329% for the Ampthill movement, and 332% for both the Duarte and Washington movements. The variable cost of the challenged movements must be calculated in accordance with Simplified Standards at 26, 84 (with no movement-specific adjustments to URCS).⁷⁹

CSXT is ordered to reimburse DuPont for amounts previously collected above the prescribed R/VC level, together with interest to be calculated in accordance with 49 CFR 1141. CSXT is also ordered to establish and maintain rates for movements of the issue traffic that do not exceed the maximum reasonable rates prescribed in this decision.

The record does not provide the data needed to calculate the total amount of reparations due to the shipper for past shipments. Following our standard practice in such circumstances, the parties are to calculate the total amount of reparations and interest due in accordance with this decision. If they cannot agree, the parties should bring the dispute to our attention for prompt resolution.

F. Limit on Relief

Cases that proceed under the Three-Benchmark method are limited to \$1 million in total rate relief over a 5-year period. Simplified Standards at 26-33. This limit applies to the difference between the challenged rate and the maximum lawful rate, whether in the form of reparations, a rate prescription, or a combination of the two. Accordingly, the rate prescription set in this decision will automatically terminate once DuPont has received the \$1 million of relief. (The length of the prescription may be less than 5 years if the limit on relief is reached in a shorter time.) DuPont will be barred from bringing another complaint against the same rate for the remainder of the 5-year period.⁸⁰

Once the rate relief is exhausted, CSXT's rate-making freedom will be restored, with a regulatory safe harbor at the level of the challenged rate for the remainder of the 5-year period, with appropriate adjustments for inflation using the rail cost adjustment factor that is adjusted for productivity (RCAF-A).⁸¹ If, however, CSXT establishes a new common carrier rate once the rate prescription expires, and the new rate exceeds the inflation-adjusted challenged rate, DuPont may bring a new complaint against the higher rate.

⁷⁹ For purposes of calculating the variable cost of the issue movements, we use actual mileage (as used by the carrier), not the mileage from the "PC*Miler|Rail" program (as used by the shipper).

⁸⁰ CSXT argues that the potential recovery should be distributed evenly over the 5-year period, lest DuPont obtain \$1 million in relief in the early years, then switch the source of its product and challenge that rate as unreasonable. CSXT Reb. at 3-4. That would be inconsistent with Simplified Standards, at 28. Should DuPont re-source this product, CSXT may argue at that time that any rate complaint challenging the rate for the re-sourced product should be barred or brought under a more sophisticated rate standard.

⁸¹ See Railroad Cost Recovery Procedures, 5 I.C.C.2d 434 (1989), aff'd sub nom. Edison Elec. Institute v. I.C.C., 969 F.2d 1221 (D.C. Cir. 1992).

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Defendant shall, within 60 days, establish and maintain rates for the issue traffic that do not exceed the maximum reasonable rates prescribed by this decision.
2. Defendant shall pay reparations and interest, in accordance with this decision, for all shipments moving after the expiration of the contract between the parties and prior to the establishment of a reasonable rate pursuant to paragraph 1.
3. This decision is effective on the date of service.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey.

Anne K. Quinlan
Acting Secretary